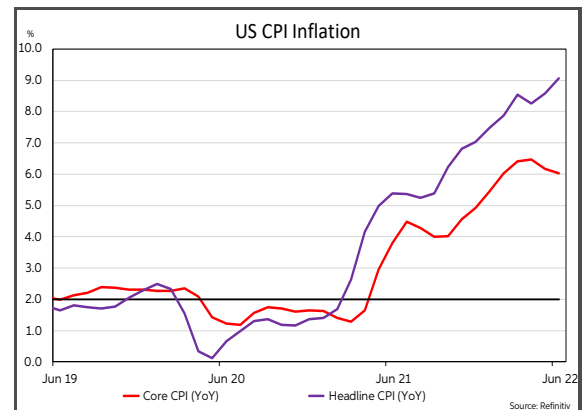


## A Grimm Tale

- The latest Bank of England Monetary Policy Report certainly caught people's attention.** It lays bare the impact of soaring energy costs on the UK economy. Inflation is now seen peaking at an eye-watering 13% this autumn, up from the forecasts in the Bank's previous Report in May of close to 10%. This reflects, in particular, the further very steep increase in the price of natural gas over the summer amid falling Russian exports to Europe. The hit to real household disposable incomes is substantial, with the Bank forecasting that they will decline by close to 4% during 2022-23. As a result, the Bank is now expecting a recession for the UK economy next year, with GDP projected to fall by between 1.0% and 1.5% in 2023, depending on the course of energy prices. Growth is expected to remain very subdued in 2024-25.
- It is the surge in gas prices that is doing the real damage according to the BoE.** Brent oil prices are expected to average close to \$100 per barrel this year. This is high, but not that very far above their average of \$78 per barrel for the period 2010-2019, or indeed, last year's level of \$79 per barrel. By contrast, wholesale gas prices in the UK are likely to average 420 pence per therm in 2022 according to the BoE. This is an eight fold increase on their level over the period 2010-20 when they averaged 52 pence per therm. The marked fall in the flow of gas from Russia to Europe and fears of a complete cessation in supply over the winter are responsible for the enormous surge in global gas prices.
- The Bank acknowledges that the risks around its projections are exceptionally large at the present time and there is a range of plausible paths for the economy.** Thus, it has produced a number of alternative economic scenarios, but all show very high inflation in the near-term and thus a fall in GDP next year. Inflation, though, is forecast to decline sharply over the medium term under all its scenarios from a combination of static or lower energy prices and recessionary conditions in the economy. Indeed, inflation is seen declining to below its 2% target by end 2024 and falling even further to under 1% in 2025. All this makes it very challenging for the BoE to set monetary policy at the present time.
- The Bank rate was raised by 50bps at this week's meeting to 1.75%, representing an acceleration in the pace of tightening from the 25bps hikes seen since December.** The Bank warned that policy is not on a pre-determined path and the 50bps hike does not imply that rates will now be raised in 50bps steps at forthcoming meetings. Markets expect the Bank to raise rates to a peak of circa 3% by early next year. The peak could turn out to be higher or lower. The surprising thing, though, given the Bank's medium-term projections for growth and inflation, is that markets see rates being cut only modestly to a floor of 2.25% in 2024-25. Rates will go far lower if the Bank's projections are anyway close to the mark. It may be that markets think it will prove to be very difficult to get inflation back down to 2% or below in the coming years.
- Turning to the week ahead, a timely update on the UK economy in the form of the first reading of Q2 GDP will feature.** The monthly readings have been mixed so far in the quarter, with GDP falling by 0.2% in April due to a decline in pandemic related spending, before rebounding by 0.5% in May, despite a softening in consumer spending. However, the double bank holiday for the Queen's Platinum Jubilee is likely to see GDP contract again, by 1.3% in June. Overall, the Bank of England believes GDP will fall by 0.2% in Q2, which is in-line with the consensus. Meanwhile, industrial production, which rose by 0.9% in May and was a large contributor to the rebound in growth in the month, is projected to decrease by 0.8% in June. Manufacturing output, which also rose sharply in May is expected to fall by 1.2%.



- In the US, the main release of note will be CPI inflation for July.** Over the past number of months, two trends have emerged regarding the CPI data; firstly, the headline rate has printed above the consensus, and secondly, a growing divergence between the headline and core rates has developed, with the former moving higher and the latter edging lower. For July though, it is envisaged that the second recent trend will go into reverse. Headline CPI is projected to ease to 8.7% from 9.1%, as fuel prices charged at the pump fell significantly throughout the month. In contrast, core-CPI is forecast to rise to 6.1% from 5.9%. Elsewhere in the US, the University of Michigan measure of consumer sentiment is expected to inch up to 52.3 in August, from 51.5 in July, and an all-time low of 50 in June.
- In the Eurozone, industrial production data are also due.** Output is thought to have stagnated in June, leaving industrial production at the same level in Q2 as it was in Q1.

	Interest Rate Forecasts			
	Current	End Q3	End Q4	End Q1
		2022	2022	2023
Fed Funds	2.375	2.875	3.375	3.375
ECB Deposit	0.00	0.50	1.00	1.25
BoE Repo	1.75	2.00	2.50	2.75
BoJ OCR	-0.10	-0.10	-0.10	-0.10

Current Rates Reuters, Forecasts AIB's ERU

	Exchange Rate Forecasts (Mid-Point of Range)			
	Current	End Q3	End Q4	End Q1
		2022	2022	2023
EUR/USD	1.0170	1.02	1.04	1.06
EUR/GBP	0.8427	0.85	0.86	0.87
EUR/JPY	137.62	135	135	135
GBP/USD	1.2067	1.20	1.21	1.22
USD/JPY	135.28	132	130	127

Current Rates Reuters, Forecasts AIB's ERU

Date	UK & Irish Time	Release	Previous	Forecast
<b>This Week:</b>	<b>ECB Speakers:</b>			
	<b>BoE Speakers:</b>	Pill (Wed)		
	<b>Fed Speakers:</b>	Evans (Wed)		
<b>Mon 8th</b>	<b>JPN:</b>	00:50 Trade Balance (June)	-¥1,186bn	
	<b>JPN:</b>	00:50 Economy Watchers Poll (July)	52.9	
	<b>EU-19:</b>	09:30 Sentix Index (August)	-26.4	-24.7
<b>Tue 9th</b>	<b>US:</b>	11:00 NFIB Small Business Optimism (July)	89.5	
<b>Wed 10th</b>	<b>CHINA:</b>	02:30 PPI (July)	(+6.1%)	
	<b>CHINA:</b>	02:30 CPI (July)	+0.9% (+7.5%)	
	<b>GER:</b>	07:00 Final HICP (July)	+0.8% (+8.5%)	+0.8% (+8.5%)
	<b>ITA:</b>	09:00 Final HICP (July)	-1.1% (+8.4%)	-1.1% (+8.4%)
	<b>US:</b>	13:30 CPI (July)	+1.3% (+9.1%)	+0.2% (+8.7%)
		- Core CPI	+0.7% (+5.9%)	+0.5% (+6.1%)
<b>Thu 11th</b>	<b>UK:</b>	00:01 RICS Housing Survey (July)	65	60
	<b>IRL:</b>	<b>11:00 CPI Inflation (July)</b>	<b>+1.3% (+9.1%)</b>	<b>+0.4% (+9.1%)</b>
		<b>- HICP Inflation</b>	<b>+1.6% (+9.6%)</b>	<b>+0.4% (+9.6%)</b>
	<b>US:</b>	13:30 PPI Final Demand (July)	+1.1% (+11.3%)	+0.2% (+10.4%)
		- Ex-Food & Energy	+0.4% (+8.2%)	+0.4% (+7.6%)
	<b>US:</b>	13:30 Initial Jobless Claims (w/e 1st August)	+260,000	+265,000
<b>Fri 12th</b>	<b>UK:</b>	07:00 GDP (Q2: First Reading)	+0.8% (+8.7%)	-0.2% (+2.8%)
	<b>UK:</b>	07:00 GDP (June)	+0.5% (+3.5%)	-1.3% (+1.2%)
	<b>UK:</b>	07:00 Industrial Output (March)	+0.9% (+1.4%)	-0.8% (+1.6%)
		- Manufacturing Output	+1.4% (+%)	-1.2% (+1.3%)
	<b>FRA:</b>	07:45 Final HICP (July)	+0.3% (+6.8%)	+0.3% (+6.8%)
	<b>SPA:</b>	09:00 Final HICP (July)	-0.5% (+10.8%)	-0.5% (+6.8%)
	<b>IRL:</b>	<b>11:00 Residential Property Price Index (June)</b>	<b>+0.8% (+14.4%)</b>	<b>+0.5% (+13.4%)</b>
	<b>EU-19:</b>	10:00 Industrial Production (June)	+0.8% (+1.6%)	+0.0% (+0.7%)
	<b>US:</b>	15:00 Preli. Uni. Of Michigan Sentiment (August)	51.5	52.3

◆ Month-on-month changes (year-on-year shown in brackets)

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